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The Advantages of National Operation

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IN considering possible solutions of the railroad problem, the fundamental purpose to be achieved is clear. As stated by the Interstate Commerce Commission, it is "to secure transportation systems that will be adequate for the nation's need, even in time of national stress or peril, and that will furnish to the public safe, adequate and efficient transportation at the lowest cost consistent with that service." Implied in this definition is the need for credit, so that adequate supplies of capital may be secured at minimum cost; the need for efficient management; the need for the best utilization of facilities, regardless of ownership; the need for relations with labor which will avoid disastrous interruptions of service and ensure whole-hearted, willing work. Having in mind these ultimate ends, I have been brought to the conclusion that they can best be attained if the roads continue in the possession and control of the nation.

CREDIT AND CAPITAL

One of the impelling reasons for this belief is the matter of credit. It is a vital phase of the problem, upon which much stress has for some time been laid by financiers. Our railroads are never finished, or at least ought not to be, and require a steady inflow of capital. Without it they cannot long furnish good service. The amount required each year runs into very large sums, and half a billion dollars is a conservative estimate, for many have set the figure higher.

With national operation the credit of the United States is squarely behind the roads, and capital can be obtained at low cost, as and where needed and without underwriting syndicates, commissions, or bankers' profits. It has been suggested that the nation's own interest rates would rise if it should continue in this field, but while this might be true in some degree it is impossible to believe that the Government would ever have to pay as much for its money as private enterprise. The total demand

for capital would in no way be increased and the elements of speculation and risk which add to interest charges would be removed, so far as railroad investments were concerned.

Under private operation the average cost of capital will be higher and not a few companies will find difficulty in securing capital at all. In the last analysis, the credit of private railroad corporations depends upon ability to issue *common stock*. Most of our roads are already heavily bonded, and unless they can market new stock, none of their securities will long attract investors. Inevitably this means high capital cost and the need for very large earnings. Before the war, carriers asserted that new stock could not be sold without income sufficient to pay at least 6 per cent dividends, with a protective margin of 3 per cent on par value each year for reserve purposes. Under present conditions, with the great demand for capital all over the world and prevailing high interest rates, there is little doubt but that 6 per cent will fall short of making railroad common or even preferred stock an attractive investment. Certain recent issues of railroad bonds bearing this rate of interest have sold below par. Financiers are now claiming that to ensure good credit net income must equal at least 125 per cent of the amount necessary to pay interest and such dividends, *however great*, as may be required to market new stock.

The situation is complicated by the so-called "weak" roads, which, either because of overcapitalization, poor location, mismanagement or improvident investments, are unable to produce necessary earnings on stock at a level of freight and passenger rates entirely adequate for other roads in the same general territory. To maintain credit upon a sound basis and enable the carriers generally to attract capital in accordance with their needs, private operation will, I fear,—unless there are extensive reorganizations—require either a government guaranty or, in the alternative, the raising of rates to an unreasonably high and excessive level.

A government guaranty coupled with private management is unsound in principle and will not meet with public approval. A guaranty of a minimum return is likely to impair rather than improve credit, because of the fear that the minimum in practice will tend to become the maximum. A guaranty of a larger

return is still more undesirable. The government can hardly afford to enter upon the policy of using the public treasury to ensure returns in private industries where deficits may arise from errors of judgment, or worse, from men over whose appointment or continuance in office it exercises no control.

I am aware that numerous plans have been suggested for overcoming the difficulty of the weak roads, either by lowering the bars against mergers and encouraging consolidations or by using the surplus of the strong for the benefit of the weak. But none of these plans seems particularly promising or likely in actual operation to cause much public satisfaction. The practical difficulties in the way of bringing about further consolidations on any large scale—in deciding what they are to be, in agreeing upon or fixing the terms, in dealing with state laws, in arranging the necessary exchanges of securities—are very great. If experience is any criterion, the chief beneficiaries for some time to come would be the bankers and lawyers in charge of the negotiations. As for the plans for a compulsory sharing of earnings, direct or indirect, aside from their complexity they could become effective, if at all, only against the opposition of the strong roads and after litigation; and they offer to some at least of the weak roads a hope of gain beyond their just deserts.

Moreover, under any of the plans for private operation which do not involve a government guaranty, credit is dependent wholly upon earnings, and rates must be placed at the level which will produce the required amounts. There is no such compelling necessity under public operation. Broadly speaking it is true that any other course would be unsound policy, but there are exceptions to this general rule and they are well illustrated by the present situation. There never was a time when conservatism in raising rates was more desirable, for we have had ample reason of late to fear the coming of a vicious circle of advancing wages and prices. Increases in freight rates have results more far-reaching than many believe, affecting as they do every item of the raw material as well as the finished product. The roads have recently been operating with earnings which would drive many of them to bankruptcy if they were in private hands; but the Director General has felt, and I think wisely, that the depression in revenue might be the temporary result of

the uncertainty following the cessation of hostilities and that the country can better afford, for a time at least, to carry the burden through taxation, as a part of the war cost, than to suffer further advances in rates whose ultimate effects no man can foretell. Backed by the resources of the nation the Director has been able to base his policy upon this belief; but it must be clear that no such policy could be pursued, either now or in any similar situation in the future, if the roads were in private hands.

BENEFITS OF UNIFICATION

The advantages of national operation are equally clear in the case of the utilization of existing facilities. Any one who will study carefully what the Director General and his aids have been able to do in the way of relieving and avoiding congestion and expediting service, under unfavorable conditions, through the unification of lines, terminals and equipment, must appreciate the possibilities in this direction; possibilities which even yet have only partially been grasped, and which expand as we look forward to the coming electrification of the properties and the development of terminal facilities. With public operation progress in realizing the benefits of unification need only be continued. Under private operation such progress is bound at best to be hampered and delayed by the conflicting interests of rival companies.

THE QUESTION OF EFFICIENT MANAGEMENT

It is when we come to the question of efficient management, I think, that the most doubt exists in regard to national operation. Among business men there is a widespread feeling that the roads ought not to remain under federal control. This is based upon a belief in the virtue of "private initiative," strengthened by an impression that the roads have not been well managed since they were taken over; upon the fear that federal control will be used for political purposes; and upon a distrust of what are termed "socialistic" enterprises and the desire to avoid an "entering wedge" in this direction.

While no doubt many expressing such views, particularly among bankers, lawyers and railroad executives, are actuated by motives of self-interest, conscious or unconscious, the general sincerity of this body of opinion is not to be questioned or its

importance and weight denied. Yet I believe that it is not well founded and that, if followed, the best results for the country will not in the end be secured.

“Private Initiative”

Faith in “private initiative” springs, I think, from experience in competitive industries. Probably it is true that maximum efficiency is a product of the struggle where profits and even the right to live depend, by reason of keen competition, almost wholly upon efficiency. Competition has been a factor in railroad enterprise, but its influence has lessened with the combinations which have been formed and with the public regulation which has been established, and will shrink still more if further extensive mergers are encouraged. It can be argued with much reason that its disadvantages have been as great as its advantages. Moreover, the assumption that private railroad owners have a peculiar self-interest in efficient management and economical operation has slender foundation. Those who use the railroads and pay for the service rendered have a greater interest in these matters. The primary interest of a stockholder is in dividends, and these may be obtained under even very poor management, provided rates are sufficiently high. The tendency of railroad stockholders for some time past has been to think more of rates than of management.

It will also be conceded that the control which is exercised by these stockholders, especially where the stock is widely held, is more often apparent than real. In practice actual control usually falls into the hands of bankers, and experience has shown that efficient management and economical operation are frequently not their most immediate concern. It is only necessary to instance the reports in the comparatively recent investigations of the New Haven, Frisco, Pere Marquette and C. H. & D. railroads to evidence this point, without reaching back into still more unsavory history. Even those most keenly desirous that the roads should have the benefit of “private initiative” are sufficiently apprehensive of the manner in which it might be exercised, so that they wisely urge stringent and costly governmental supervision, not only over rates, but over capitalization, mergers, new construction and service as well. Indeed the

chasm between public operation and private operation of the kind now generally proposed is really not so wide as many think.

The choice, therefore, is not between national operation and "private initiative" such as is manifested in highly competitive industries where success is inseparable from efficiency, but between national operation and "private initiative" in a field where competition is much less a factor, if it is to be a factor at all; where prosperity is deemed to be dependent chiefly upon rates; and where it is thought necessary to protect the public interest by duplicate, complicated, costly and continually expanding machinery for public regulation and control.

The Success of Federal Control

So far as the sentiment in favor of a return to private operation springs from a feeling that "federal control" has been a failure, it is not justified. The railroads were taken over in time of war and placed in charge of a Director General. So sudden and radical a change in the administration of an immense industry was never before made in this country. Even if conditions had been normal and favorable, no one could reasonably have expected that the new plan of administration would at once be perfected, or that serious mistakes would not occur. As it happens, conditions were neither normal or favorable. The change came on the eve of the worst winter in railroad history, at a time when great congestion existed in the eastern territory; the properties were in none too good condition, it was necessary to concentrate attention upon the movement of troops and munitions, the supply of skilled labor was depleted both by the draft and by the demands of war industries, and prices were soaring rapidly.

In spite of these handicaps, no one denies, I think, that the Railroad Administration succeeded in relieving congestion and handled both troops and all manner of war freight with great credit to itself. It is also conceded that it was able, through unification, to bring about improvements in operation and terminal practices which were of marked benefit. The more, indeed, its record is studied, the more it will appear that operation both before and after the armistice has on the whole been well conducted, in some respects better than ever before. Nor do I think that any well informed person has charged that fraud or

graft has been permitted to enter in. The division directors and federal managers were chosen from men who had made their mark in railroad work, and obviously without regard to political affiliations. Comparatively few actual changes were made in executive positions.

CRITICISMS OF FEDERAL CONTROL

The chief criticisms of the Railroad Administration, aside from irritation over reductions in passenger service incident to war conditions and a part of the railroad program prior to federal control, appear to be these:

- (1) That large increases in rates have been made.
- (2) That, notwithstanding these increases, expense of operation has risen to such a height that the roads are not paying their way, but imposing a grievous burden upon the public treasury. It is alleged that much of the increased expense has been due to unjustified increases in wages, and to the employment of more men than necessary.
- (3) That radical changes in rate structure and established practices have been made or proposed in an arbitrary way, and that centralization has given rise to bureaucratic methods, to disregard of local interests, and to undue standardization.

Increase in Rates

While rates have been raised, it is common knowledge that the increases as a rule have fallen short of the contemporaneous increases in the prices of staple commodities. A unit of most commodities will now buy more transportation than ever before. If the roads have not been wholly paying their way it is due, not only to the increase in operating expense, but to the fact that the standard return (upon which the deficit is figured) was based on the average of three very excellent railroad years, and to the further and more important fact that traffic fell off sharply after the signing of the armistice. With returning traffic the showing in recent months has been much better.

Wages and Efficiency of Labor

Increases in wages have been large; but I do not believe it will be found that they have been disproportionate, on the whole,

to the rise in the cost of living or to the increases granted in most competitive industries. Perhaps standardization may have been carried too far in some cases, but it may be questioned whether the situation would have been essentially different if the roads had remained in private hands. The pressure of the cost of living and the rise of wages generally would have made increases on the railroads inevitable. No doubt the process would have been a threatened strike and reference of the matter to the National War Labor Board, or to some special board of arbitration. As it happens, the major increases under federal control followed the unanimous finding of a bi-partisan board of this character.

It is probably true that during the war the efficiency of railroad labor decreased, more particularly in the shops. But it does not follow that this was the result of federal control. Chiefly it was due to the impairment in personnel and discipline caused by shortage of labor—especially of skilled mechanics, who were drawn by the thousands into shipbuilding and other war industries. The decrease in efficiency was noted before the roads were taken over, and I know that it was equally, if not more strongly, marked in the case of street railways which remained under private management.

As to the charge that more men than necessary have been employed, it appears that the introduction of the 8-hour day in some cases caused an increase in the force, that the federal managers are largely the same men who were in charge of operation prior to federal control, and that no orders have been issued from Washington requiring these managers to employ more men than the needs of the service demand.

Arbitrary Changes in Rate Structure

There is more basis for the criticism that important changes in rate structure and practices have been arbitrarily made, and that there has been over-centralization of authority. The incidents which gave rise to this complaint, however, very largely occurred in the inception of the new mode of administration and under stress of war conditions. Under the policy which has prevailed since the signing of the armistice it will hardly be claimed that the Director General has been guilty of arbitrary

action. And even if he had been, or if there has been undue centralization of authority, the fault is not one which is incapable of remedy.

I have gone into this phase of the matter at this length because of the prominence which this unfounded impression as to the efficiency of operation under federal control has assumed in the ordinary discussion of the railroad problem. Hasty and superficial conclusions have been drawn without adequate consideration or conception of all the factors which have entered into the situation, and even without apparent thought of comparing the rates and service of the railroads under the pressure of war and post-war conditions with the prices and service of ordinary industrial enterprises during the same period. Summing up the situation, there are grounds for criticism of operation and policy since the beginning of federal control. Most of these were products of the times in which we have been living and could not have been avoided. For some the Railroad Administration may properly be held responsible. But none of them justifies the conclusion that national operation is unsound in principle or that it ought to be abandoned.

To the distrust of "socialistic" experiments little weight need be attached. "Socialistic" is a catchword loosely used as a means of discredit in default of argument or thought. It has long been recognized that transportation by rail is a *public business* which the government might properly carry on, and it is no more "socialistic" to do so than to provide and care for schools, highways, water supply, postal facilities, irrigation, fire protection, and any number of other activities now publicly administered. The question is one of practical expediency rather than of political theory, and the fear that national operation of this public business will prove an "entering wedge" for the nationalization of what is more strictly *private* industry is not warranted.

THE GOVERNMENT AS A BUSINESS ENTERPRISER

Nor need we hesitate to adopt the policy of national operation because of the fear, so frequently expressed, that the government is unsuited to carry on a business enterprise. It may be granted that as a nation we have often been guilty of wasteful, dilatory and unbusinesslike practices in the conduct of our public affairs,

although I have little doubt that a critical examination of our record in irrigation, the forestry service, the geological survey, the construction of the Panama Canal, and the activities of the Agricultural and other departments, would disclose many instances to the contrary. But such an admission of shortcomings is far from saying that the problem of securing efficient administration of public business is beyond the capacity of American ingenuity, determination and public spirit. It might as well be argued that the obvious mismanagement of many railroad corporations in the past is proof that "private initiative" cannot produce good management. The truth is that very little attention has been given to the solution of this problem.

After some experience in both state and federal employ, I am confident that no greater opportunity for useful, genuinely creative and hence enjoyable work anywhere exists than in the public service, and that the great body of employes are faithful, loyal and willing to work. I feel sure, also, that American voters have no desire to see graft, waste or "politics" enter into railroad management, and that any national administration guilty of fathering such management would be equally guilty of the most short-sighted political judgment. Nor is it possible to believe that able men would be less willing to accept railroad positions of power and eminence where their work would be primarily for the general welfare rather than for private gain. There is no sound reason to believe that the problem of efficiency is hopeless, or one that cannot be solved if constructive thought is devoted to it in sufficient measure. A little later I shall offer certain suggestions in this connection.

PARTICIPATION OF RAILWAY LABOR

At present the labor question is a most important phase of the railroad problem. Industrial warfare upon the railroads spells ruin. It is more than a question of strikes. Every one knows that the country cannot long endure a stoppage in its transportation arteries, but not every one realizes how closely the furnishing of good service at reasonable rates is bound up with loyal coöperation between the men and the management. It is but one aspect of the question which is agitating the whole world at the present time, how to secure whole-hearted, willing work and increase production.

Labor is fast coming to realize that increases in wages may not of themselves achieve desired results. Events in this country in recent months are significant of that fact. Indeed there are probably only two ways in which workingmen can permanently better their condition. One is to reduce excessive profits and place the burden of taxation where it can most easily be borne; the other, and the more important in its direct results, is to increase per capita production and thus lower the cost of production and bring down prices.

One of the great obstacles to achieving this most desirable end has been the suspicion of labor that any added zeal in work would merely redound to the benefit of private capital. Another has been the fact that the laborer has too often been regarded as a mere tool of production rather than as a human partner in the enterprise, and has lacked personal interest in his work. No doubt this situation, so far as it exists upon the railroads, may be improved by changes in methods under private ownership; but it may more readily be remedied under national operation.

With national operation the return of capital will be fixed or limited, and there will no longer be foundation for the fear that heightened effort will but add to the direct or indirect profits of private owners. Moreover, with all the roads under a single governmental control, the policy of giving labor a voice and personal interest in the conduct of the business can more easily be adopted and carried into uniform and successful practice.

The very fact that the railroad employes themselves favor the nationalization of the roads will simplify the task. I realize that there are many who fear that this will result in a formidable political alliance between the employes and the government; but let those who hold this fear recognize the fact that even under private ownership the government is bound to be the ultimate, deciding factor in any critical labor controversy. It has been so in the past and it will be so in the future, for the concern of the entire country in any such controversy is too great to be ignored. The government can, I believe, deal with the problem with a surer and firmer hand if it deals directly than if it deals indirectly; and the saving factor in the situation is the truth that the real interests of the employes are identical with the interests of the country.

SUGGESTIONS FOR PERFECTING GOVERNMENT OPERATION

As to the form which national operation ought to take, it is generally agreed that private operation has had many defects in the past and much thought is being spent upon possible means of curing these defects. The mistake lies in assuming that flaws in private operation are less vital and easier of remedy than flaws in public operation. Most of the plans for a return to private operation are highly complex and involve so large an element of public control that exercise of "private initiative" will at best be circumscribed, the ultimate responsibility for good service and reasonable rates will rest with the government, and much energy will be lost in costly processes of regulation, duplicating, in many respects, the processes of management. There are so many patent elements of strength, simplicity and power in national operation, at a time when these advantages are sorely needed, that the thought of the country may well be directed to the perfecting of federal control, rather than to its abolition. In this connection I venture to make the following general suggestions:

(1) Too much power has been granted, particularly over rates. This has resulted at times in arbitrary action which has led to the fear that such action may be more frequent in the future. The present rate structure is far from perfect; but our industries have been built upon it and it ought not to be too suddenly or too violently disturbed. No important change should be made without opportunity for full hearing before some disinterested tribunal. The Interstate Commerce Commission has been dealing with rates for years and is well organized for the purpose. It should have the same power over rates under national as it has had under private operation.

The Commission should, I think, also retain its control over accounts and its powers of research and investigation. The state commissions should be permitted to retain similar powers and to exercise much of the authority over service which they now possess. These local tribunals, easily accessible and independent of the federal government, can be of great public benefit. The more opportunity there is for intelligent and informed criticism from independent sources, the better national operation will be.

(2) There has been over-centralization of authority. The roads nationally operated should, I think, be divided into regional or other systems, and these should have a large measure of autonomy or "home rule," so that all minor policies and some of greater moment can be determined on the spot. By instituting comparisons between these systems, rivalry can be stimulated and benefit derived.

(3) While the federal government should retain ultimate control, the suggestions which have been made that independent interests be given direct representation in the management are well worthy of consideration. Such representation would no doubt offer a valuable check against the political and business evils of public operation which so many fear. In this connection, the business men who use the roads have an obvious self-interest which, as I have indicated, is less divided than that of private stockholders. The reasons for giving the employees representation in the management have already been stated, but that representation should not, as is now being urged, be either superior or even equal to that of the government in behalf of the entire public.

These are only general suggestions and I have not attempted to develop them in any detail. The problem is largely one of organization and the important thing at the moment, if Congress could see it in that light, is to turn attention in this direction. If this were done, without doubt the Director General and his aids, representatives of shippers and employees, and many others could give valuable help in devising ways and means for improving the organization and supervision of national operation so that it may better accomplish the purposes which all desire. It is a question which could be dealt with without haste, and the same may be said of the still more difficult question as to the compensation finally to be paid to the owners of the roads if the policy of national operation should be permanently adopted. Probably this latter question could more wisely be determined in the light of the valuation which is now in process, but the suggestion is well worthy of consideration that a trade might be made, giving to present railroad security holders government bonds yielding a return equivalent—government credit being considered—to the return received in the past under normal conditions. In the meantime all that is needed is to continue federal control

in its present form for an appropriate period of time, so that uncertainty as to the immediate future may be ended and sufficient time gained for the deliberate and constructive consideration of the form which national operation should finally take.

Summing up the situation, having in mind the conditions by which the country is now faced, it is my firm conviction that it is unwise to return the railroads to the uncertainties of private financing, and the confusion bound to ensue upon the inauguration of new schemes of public regulation, the raising of rates, and attempts at mergers and the pooling of interests, not to speak of labor complications. The nation will better conserve its strength and resources if federal control is continued and if all who are interested in efficient and economical operation will unite their energies to achieve that end under such control. If supported without prejudice, rancor or partisanship, this policy can be made to promote national pride and unity and add to the power of the country.